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Intelligence Memorandum

Some Economic Consequences Of Two Pakistans

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
May 1971

INTELLIGENCE MEMORANDUM

SOME ECONOMIC CONSEQUENCES OF TWO PAKISTANS

Introduction

1. The civil war in East Pakistan, with the accompanying disruptions in trade between the two wings, demonstrated dramatically the extensive interdependence that has developed between them since the union was formed. For example, the virtual halt in jute exports from East Pakistan divested the West of the foreign exchange earnings that normally flow to it in payment for inter-wing trade. At the same time, the West wing's textile industry could not ship its products to the East – its major outside market.

2. Islamabad's military successes in the civil war have probably only postponed the establishment of two separate Pakistans. This memorandum evaluates the economic links between the two Pakistans and some of the short-term implications of a halt in trade to the economies of both wings.

Discussion

Background

3. Economic relations between the two wings of Pakistan expanded rapidly following independence in 1947, and by 1970 each was the other's major trading partner. Both were protected by the same tariff walls against the outside world, and capital was able to flow freely between the two wings. This free movement of goods and capital in an expanded domestic market benefited both wings to the extent that each provided a market

Note: This memorandum was prepared by the Office of Economic Research and coordinated within CIA.

for many products that the other could not sell profitably elsewhere, given the limitations on trade with India. 1/

4. While economic relations were expanding, however, so too was the disparity in living standards between the two wings. Whereas there was little difference in per capita incomes when the union was formed, they are now about 50% higher in the West than in the East. In the West, economic progress was favored by a better inheritance in the form of a developed infrastructure, a population that was already 20% urban, and an inflow of entrepreneurial talent from India. Economic development in the East – largely a backward, greatly overpopulated agricultural economy which lost much of its entrepreneurial class to India – depended almost entirely on funding received from the West-dominated central government. Such funding did not become substantial until the 1960s, however, and private investment remained small. Consequently, economic growth in the East was very slow.

5. The "Green Revolution" in Pakistan in the late 1960s occurred almost exclusively in the West, 2/ and constituted a highly visible manifestation of its greater economic success. Subsequently, the floods and cyclone of 1970, which devasted large areas of East Pakistan, further underscored that region's vulnerability and helplessness. 3/ Moreover, the slow response by the central government – located in West Pakistan -- to the disaster that followed the November cyclone may have been decisive in the overwhelming scope of the victory of the separatist-oriented Awami league in the East's December 1970 elections.

6. In any event, practically all Easterners are convinced that they have been exploited by the West, and most believe that they would be better off, or at least no worse off, as an independent nation. In the event of a split, each wing would have to develop new trading patterns. The difficulty of the adjustment and the prospects for economic growth would depend also on the distribution of foreign indebtedness and foreign exchange assets.

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An Independent West Pakistan

7. As a separate economy, West Pakistan would lose access to East Pakistan's market and would need to find alternative sources of supply for the goods that it has been importing from that region. A review of West Pakistan's trading patterns in 1970 provides some insight into its likely foreign trade situation as an independent nation. West Pakistan registered a deficit of $352 million in its foreign trade, as exports totaled $338 million and imports $690 million. In its trade with East Pakistan, West Pakistan had a surplus of $78 million (exports of $174 million and imports of $96 million). Thus the inclusion of inter-wing trade cuts the deficit to $275 million (see Table 1). 4/

8. The West, however, could not find alternative markets for goods now sold in the East. Its exports to the East -- $174 million in 1970 -- are about one-half of those to the rest of the world. The principal commodities are food, textiles, and raw cotton (see Table 2), all of which are items currently being sold in foreign markets. But the textile and food products sold to the East are of low quality and, therefore, not readily disposable in foreign markets. Other manufactured items are consumer goods - shoes, drugs, and medicines, etc. - plus cement, and a little machinery, many of which would not be competitive in world markets. We estimate that an independent West Pakistan would be able to redirect less than half of its sales to East Pakistan to other markets in the first year or two following the split.

9. Prospects for increasing the West's ongoing foreign exports are uncertain. While West Pakistan has succeeded in doubling its textile exports since 1955, further growth may be constrained by quotas in some of its largest markets, the United States and Western Europe. On the other hand, exports of raw cotton have fallen as domestic consumption has increased. A reduction in textile production - as a result of an inability to export abroad some of the output currently sold to the East wing - would open up the possibility of increased exports of raw cotton. Some surplus foodgrains, now shipped to the East, might also be exported. On the whole, however, West Pakistan in the shortrun cannot expect to increase its export receipts enough to offset the loss of sales to the East.

10. Thus, unless it reduces its imports, West Pakistan's trade deficit is likely to increase from what it otherwise would have been to around

4. Recent studies indicate that the official rate of the rupee -- 4.76 to the US dollar -- overvalues the rupee by about 100%. The Pakistani rupee in inter-wing trade was thus converted to dollars at the rate of 9.5 to 1, rather than at the official exchange rate of 4.76 to 1.

$400 million, assuming no change in imports. A severance of trade with East Pakistan would affect only about one-eighth of West Pakistan's imports – primarily consumer goods such as tea, jute, and paper (see Tables 3 and 4). There would be no difficulty finding foreign sources for these or substitute imports – the problem would be availability of foreign exchange. Much more than one-third of West Pakistan's imports other than those from East Pakistan are capital goods, and a curtailment would adversely affect economic development in the long run. However, West Pakistan has considerable amounts of unused industrial capacity. Thus, near-term industrial growth can be achieved even if imports of capital goods are reduced so long as imports of raw materials and intermediate goods are sustained.

11. In addition to a larger trade deficit, an independent West Pakistan would experience a serious economic recession brought on by the loss of its major market. Manufacturers of cotton textiles would lose more than two-fifths of what is currently their production for the domestic market and about one-fourth of their total market (see Table 5). The value of the lost production would be even more significant because of the premium prices paid in the East. On the basis of the textile industry's share of industrial employment, this would put as much as 10% of the industrial labor force out of work. Trade and commercial establishments also would be hit hard by the contraction of sales. The returning West Pakistanis and their capital, on the other hand, would augment the relatively large entrepreneurial class in the West, although the capital might remain unemployed for some time.

12. Agriculture in the West probably would be restructured after a split. Land utilization would shift to accommodate the altered demand patterns. The nature and extent of the shift would depend heavily on the West's success in marketing cotton and foodgrains abroad. Production of higher grade rice for the export market might well be increased, and production of the lower grades of rice probably would be reduced. This might slow the spread of the new "miracle seeds" which generally yield a low-quality rice. Oil seed production probably would increase to satisfy internal requirements and reduce imports of edible oils.

13. On balance, an independent West Pakistan would face severe economic dislocations, an economic recession, and a deteriorating balance-of-payments situation. A devaluation of the rupee, which is currently overvalued by an estimated 100%, would be essential to make foreign exports more attractive. Substantial amounts of foreign aid would be needed both to maintain economic growth and to avoid a de facto default on the nation's foreign debts.

An Independent East Pakistan

14. An independent East Pakistan also would face balance-of-payments problems, but these would not be as serious in the short-term as West Pakistan's. In 1970 the East Wing recorded a $31 million foreign trade deficit. Taking into account its deficit on inter-wing trade, the East's total deficit was about $110 million. A considerable part of the trade with West Pakistan probably could be shifted, however; the terms of trade might improve; and new trade patterns could be developed relatively fast.

15. Unlike West Pakistan, the East as a separate nation most likely would resume trade with neighboring India. Historically, East Pakistan and the adjacent Indian state of West Bengal – which includes Calcutta – formed a natural trading area. Prior to the union, East Pakistan provided food for Calcutta's population and raw materials for its industry in exchange for manufactured goods, fuels, and construction materials. Each area became progressively less dependent on the other after the partition of India, until 1965, when trade was halted, but the potential for substantial trade still exists.

16. Much of the trade with India would be in commodities now traded with West Pakistan. India could supply the East with cotton textiles and tobacco, and paper and paper products could be sold by the East to India. The East currently sells 65% of its paper production in inter-wing trade. Trade with India would be less expensive than inter-wing trade, if only because of lower transportation costs. India would not replace the West wing as a market for the East's tea, and prospects for other foreign sales are poor because of low quality.

17. Furthermore, India and East Pakistan have a large potential trade in commodities not now included in Pakistan's inter-wing trade. Although India has been forced to grow its own jute to supply the Calcutta mills, it has not attained self-sufficiency and would probably import raw jute from East Pakistan. This would probably more than offset the loss of jute textiles sales to the West wing. East Pakistan could also revive fish sales to India. India has large coal deposits in close proximity to the East, which has had to import coal from Communist China. Indian Bengal also produces cement and other construction materials that East Pakistan needs to rebuild areas destroyed by the army, to reconstruct embankments destroyed during last November's cyclone, and to build dikes to control the annual flooding during the monsoon; and India can offer a variety of machinery and transportation equipment for sale to the East.

18. East Pakistan's exports will be heavily affected not only by expanded trade with India but also by developments in the world jute

market because jute and jute products make up some 90% of total foreign exports. In an effort to increase export earnings, the East has been shifting from the export of raw jute to that of jute manufactures; nevertheless, about half of its foreign exchange earnings still come from raw jute exports. In recent years, exports of burlap have declined drastically in the face of competition from packaging made from synthetics and paper, and a further decline appears in prospect. The East's mills have been adjusting for several years to this shift in world demand by converting to the manufacture of carpet backing, for which demand is likely to continue rising, at least for the next several years.

19. The main economic problems of an independent East Pakistan would be population pressure on the food supply and a severe shortage of entrepreneurial talent and technical skill. The nation would have a substantial food deficit. If, as seems likely, there was a wholesale expulsion of West Pakistanis, the urban economy -- both industry and commerce -- would be set back. West Pakistanis also have played a major role in the development of East Pakistan's jute industry. The highly limited domestic investment resources and a shortage of entrepreneurial talent would limit East Pakistan's ability to finance and manage the economy on its own.

Implications for Foreign Aid

20. At least for the first two or three years after a split, both wings would probably need increased foreign assistance to maintain current per capita incomes. However, the aid requirements of the two wings would differ greatly in both magnitude and type.

21. The West's economy would depend on general commodity aid to cover a gap of some $400 million between its imports and its exports. Although more than self-sufficient in food, the West relies heavily on imports to support industrial development. The West could, with appropriate economic policies, develop new exports, but it would take many years to achieve self-sustaining growth.

22. For the East, foreign aid requirements in the first two or three years after the split would probably be in the range of $100-$150 million annually and would be of a type that is far easier to satisfy than the West's requirements, as it would consist solely of food aid, project aid, and technical assistance. Immediate requirements for foreign assistance would include not only food but also relief for reconstruction and rehabilitation of areas devastated by the civil war. In the longer term, large-scale aid would be needed for the massive flood control and water development projects the country must undertake to improve growth potential. Of the approximately $600 million in foreign aid disbursed throughout Pakistan in fiscal year 1970, roughly one-fourth was spent in the East.

23. Disposition of Pakistan's foreign debt between the two nations will have a significant effect on their overall balance-of-payments positions. Negotiations between the wings could result in some debt-sharing, perhaps in the same proportions as recent foreign aid disbursements. It is more likely, however, that an independent East Pakistan – emerging from a civil war imposed on its territory by the West wing – would disclaim all debts contracted by Islamabad. In any event, with a foreign debt currently at about $4 billion and annual repayments at $160 million, some debt relief would be the first order of business for whoever inherits the foreign obligations.

Conclusions

24. An independent West Pakistan is likely to experience a severe economic recession and a deteriorating balance-of-payments situation. The loss of markets in the East wing for its textiles and other consumer goods would reduce industrial production and employment. Although the West probably would be able to increase its foreign exports, the increase would not offset the loss of trade with the East, even if the rupee was substantially devalued. Dependence on foreign commodity aid to finance economic – especially industrial – development would increase. Moreover, West Pakistan would inherit most if not all of Pakistan's foreign obligations, and some debt relief would be essential to avoid default.

25. An independent East Pakistan would have a much smaller balance-of-payments problem, with aid requirements limited to food aid, project aid, and technical assistance. Trade with India would probably be resumed; it would replace much of the loss inter-wing trade, improve the terms of trade, and provide the potential for further trade expansion. Nevertheless, East Pakistan would remain a poor and backward economy with a severe shortage of managerial talent and skills, which would be worsened by an exodus of West Pakistanis. Because of this shortage, the comparative lack of infrastructure, and the high population pressure on the land, long-term growth prospects are much less favorable in the East than in the West.

Table 1

East and West Pakistan:
Inter-wing and Foreign Trade, 1970

Million US $

	Imports	Exports	Trade Balance
East Pakistan	*554.6*	*445.6*	*-109.0*
Inter-wing	173.9	96.4	- 77.5
Foreign	380.7	349.2	- 31.5
West Pakistan	*786.3*	*511.7*	*-274.6*
Inter-wing	96.4	173.9	77.5
Foreign	689.9	337.8	-352.1

Table 2

West Pakistan:
Major Inter-wing and Foreign Exports, 1970

Million US $

	Inter-wing	Foreign	Total
Total	*173.9*	*337.8*	*511.7*
Of which:			
Food	60.7	48.9	109.6
Cotton, raw	17.5	47.0	64.5
Cotton textiles	34.6	123.2	157.8
Leather	0.3	23.0	23.3
Tobacco	15.2	3.5	18.7
Machinery	6.7	2.4	9.1
Other manufactures	22.4	59.4	81.8

Table 3

East Pakistan:
Major Inter-wing and Foreign Exports, 1970

Million US $

	Inter-wing	Foreign	Total
Total	*96.4*	*349.2*	*445.6*
Of which:			
Jute, raw	--	160.1	160.1
Jute manufactures	16.9	158.6	175.5
Leather	3.0	12.6	15.6
Paper and paperboard	11.5	0.4	11.9
Tea	25.6	--	25.6

Table 4

East and West Pakistan:
Foreign Imports, 1970

Million US $

	East Pakistan	West Pakistan	Total
Total	*380.7*	*689.9*	*1,070.6*
Of which:			
Foodgrains	82.7	11.0	93.7
Other foods	7.3	19.5	26.8
Animal and vegetable oils	21.8	22.9	44.7
Chemicals	52.9	125.9	178.8
Fuels	16.3	46.2	62.5
Machinery	103.5	194.9	298.4
Transport equipment	19.6	71.4	91.0
Other manufactured goods	66.9	155.6	222.5

Table 5

East and West Pakistan: Selected Inter-wing and Foreign Exports as Shares of Provincial Production, 1970

	Inter-wing Exports as a Percent of Production	Inter-wing Exports as a Percent of Production for Pakistani Markets	International Exports as a Percent of Production	Total Exports as a Percent of Production
West Pakistan				
Cotton, raw	13.5	16.0	15.7	29.2
Cotton textiles	22.5	44.1	49.1	71.6
Cotton twist and yarn	5.4	7.3	26.8	32.2
Cement	12.3	12.3	--	12.3
Rice	17.2	17.9	3.8	21.0
East Pakistan				
Jute, raw	--	--	48.9	48.9
Jute textiles	11.0	67.1	84.6	95.6
Paper	64.5	65.1	1.0	65.5
Matches	50.2	50.2	--	50.2
Tea	93.4	93.4	--	93.4

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